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■ PREDATORY LENDING

Contradictory laws

By James M. Rockett SPECIAL TO THE NATIONAL LAW JOURNAL

PREDATORY LENDING—the very words conjure up a Dickensian picture of vile characters preying on defenseless borrowers. Chanting the predatory-lending mantra and using anecdotal evidence of unfair and, in some cases, contemptible lending practices, consumer advocates have convinced state legislatures to enact a broad range of laws aimed at limiting terms that may be included in mortgages. Even as rating agencies downgrade securitization pools containing loans affected by these laws—curtailing dramatically mortgage credit to residents of those jurisdictions—legislators, undeterred by economic realities, join the anti-predator parade.

Although banks are not among the alleged predators in the anecdotal evidence cited by consumer advocates, the anti-predator laws make no distinction. As a result, banks confront numerous conflicting state mortgage-lending standards. Seeking relief from this morass, national banks have successfully convinced their primary regulator, the Office of the Comptroller of the Currency (OCC), to articulate a uniform standard for mortgage lending by pre-empting state anti-predator laws. But requests for help from regulatory authorities are seldom free from complication, and this issue is not an exception.

A complex response

In response to the plea for consistency, the OCC published proposed rules in the Federal Register (66 Fed. Reg. 46119 (Aug. 5, 2003), for which the comment period closed in October, addressing two predatory-lending issues. First, the proposed rules identify laws that the OCC contends interfere with national banks' conduct of the business of banking and which, therefore, are pre-empted. Second, the proposal imposes new "safety and soundness" rules for determining what loans the OCC will deal with as predatory.

The first element of the proposed rules is exactly what national banks sought and will also benefit those state banks that enjoy state law parity with national banks. The second aspect is far more troubling, especially where lenders have historically looked to collateral as a primary source of loan repayment.

The OCC rule adds a new provision at 12 C.F.R. Part 7 §§ 7.4007-7.4009 setting forth the types of laws that are pre-empted and those very limited circumstances where state laws apply to national banks. In general, state laws that the OCC concedes will apply to national banks pertain to contracts, debt collection, acquisition and transfer of property, taxation, zoning, crimes, torts and homestead rights. Other state laws attempting to regulate national banks are pre-empted. This will be welcomed by bankers seeking uniform standards.

But the standards proposed by the OCC to determine whether loans by national banks are predatory and thus violate the OCC's "safety and soundness" requirements may well be inconsistent with certain loan products and customary practices of many lenders. The OCC predicates its policy on two broad principles: A national bank "should not make loans when they lack a reasonable basis to believe that the borrower has the capacity to repay the loan" and "national banks should treat all their customers fairly and honestly." Based on these generalities it proposes to add a "bedrock principle" that a national bank shall not make a loan "based predominantly on the foreclosure value of the borrower's collateral, rather than on the borrower's repayment ability, including current and expected income, current obligations, employment status, and other relevant financial resources."

Using this as its predatory lending standard, the OCC would expressly pre-empt all state laws related to: the ability of a creditor to require collateral insurance or other credit enhancements or risk mitigants; loan-to-value ratios; the terms of credit; the aggregate amount of funds that may be loaned against real estate, escrow or impound accounts; access to credit reports; mandated disclosures; the processing, origination or servicing of mortgages; rates of interest on loans; due-on-sale clauses; and other similar enumerated issues.

Before bankers cheer the new rules, they should question whether the OCC's proposed principles are realistic measures of predatory lending and whether examiners will have sufficient guidance in reviewing national-bank lending practices to make an accurate judgment in this regard. The new rule appears to deviate from the customary lending practices of many banks that look to collateral as the most significant element in making a loan. This is especially true of Community Reinvestment Act loans, loans to low-income borrowers or bridge loans. As with any subjective standard, banks may find inconsistent application of the OCC's proposed regulation from examiner to examiner. The outcome will only be known as the examiners roll into banks and begin to give practical definition to the new rules. NLJ

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